TESTIMONY OF NEIL GOLDSCHMIDT, SECRETARY OF TRANSPORTATION, BEFORE THE SUBCOMMITTEE ON TRANSPORTATION, SENATE COMMITTEE ON COMMERCE, SCIENCE AND TRANSPORTATION, NOVEMBER 7, 1979

Mr. Chairman and Members of the Committee:

The Administration and the Congress must take prompt action to solve one of the major concerns facing all Americans -- our energy problems. Today I am here to discuss reforming the regulatory structure that binds the railroads, and how freeing the railroads to compete with other transportation modes will improve service and subject rail costs and rates to the forces of the marketplace. This can improve the performance of a very energy-efficient means of transportation. Also, our railroads are critically needed to carry the vast amounts of domestic coal we will be using to reduce our dependence on foreign energy sources.

We have heard for years about the crisis in the railroad industry. This crisis has not abated. The encouraging financial reports for a few railroads this year should not obscure the worsening plight of our Northeast and Midwest carriers. The Milwaukee and the Rock Island are only the most visible examples of the problems facing the railroad system.

Three years ago with the 4R Act Congress adopted substantial reforms in all the major areas of regulation affecting the railroads, but we did not achieve the freedoms that law was designed to give to the railroads. Complicated legislative provisions and the threat of ICC intervention themselves deter the railroads from making changes. We must not repeat the mistakes of the 4R Act. For too long the railroads

have depended on signals from the ICC in setting rates and managing their operations. It is time the federal government stopped dictating answers to questions which should be answered by the marketplace.

I cannot overemphasize the need to act quickly, and I applaud the Committee's swift action. However, before I discuss specific provisions, I would like to stress the Administration's objectives in supporting regulatory reform. We are concerned above all that control of railroad pricing as well as operating and investment decisions rest as much as possible with individual railroad companies. Legislation should minimize the involvement of the Interstate Commerce Commission in internal management matters and also limit generalized, industry-wide actions to those areas in which the railroads are affected as a system. That principle applies in ratesetting, contractmaking, equipment allocation, service, capital structure, and other aspects of corporate management. We would hope that any bill would conform to this principle, not only as it applies to an individual section, but to the logical construction of the entire proposal.

The railroads are very different from each other, in the territories and markets they serve, as well as in their internal cost structure and financial condition. The present practice of granting general rate increases to the entire industry, for example, provides low-cost carriers with higher rates than their inflationary cost increases might merit, while it grants the highest cost carriers only the average level of increase. We want to obtain maximum benefits from the forces of competition that exist in transportation markets. Regulatory

provisions should prevent excessive abuses of market power, but they also should encourage the railroads to examine their own operations, calculate their costs, and determine the rates and services they offer in response to their individual markets. The Administration strongly supports the effort the Committee is making in this bill to face these problems.

To summarize what I will discuss today, our first reaction to S. 1946 is that the bill makes important progress in improving the system we use to regulate our rail industry, particularly in its approach to maximum rate regulation. We also support the strong initial steps S. 1946 takes to --

- phase out general rate increases indexed to inflation; and
- free up entry to existing markets by railroads for more head-to-head competition.

Later in my testimony I will express why we feel that modifications should be made to proposals to --

- make the division of joint rates for end-to-end service more equitable;
- stimulate the use of contract and demand sensitive rates;
- bring into the open rate-bureau practices;
- simplify procedures for abandoning marginal lines;
- simplify the review of mergers; and
- leave day-to-day operations to railroad management instead of the ICC.

Nearly a century of ICC economic regulation of the rail industry has not produced a vigorous and sound rail transportation system in the United States. The reforms proposed in your bill and S. 796 must be taken up immediately if we are to revitalize the railroad system on which we depend. As the President said in his March message to Congress on rail reform, "we must seek to create an environment in which the railroads themselves can regain their economic health by aggressively improving their operations and profitability."

Maximum Rate Regulation

The ICC may hold down railroad maximum rates, based on the complaints of shippers and others or on its own initiative. This can distort competitive market forces with other carriers, misallocate costs, and cause a railroad to defer capital maintenance or otherwise provide inferior service. On the other hand, rate regulation meets the concerns of shippers who fear they will be harmed if rate regulation is abolished.

We applaud the reforms in S. 1946 that would create a rate increase zone free from fear of protracted ICC investigation and review. This "no challenge" zone would permit a reasonable return on investment, plus whatever inflationary increases are experienced in the industry from year-to-year. Further increases of 4 percent annually, but not more than 12 percent in any 5-year period, could not be suspended, and could be challenged only by a complaint other than the ICC's. The burden of proof of unreasonableness would be on the protestant rather than the carrier. Higher increases would fall under the existing system, with shorter investigations, and without proving first that the railroad dominates transportation in that particular market.

We believe S. 1946's approach to maximum rates and protection to the captive shipper has merit. As you continue to review this section you should assure the ICC fully takes into account the shipper's transportation alternatives when investigating a rate, as well as other market-related limits on a railroad's pricing flexibility. The use of industry averages, as called for in S. 1946, to determine a return on investment, will affect railroads quite differently depending on their cost structures. Also, we suggest the bill limit ICC-determined maximum rates only to the protesting shipper rather than all who would normally obtain the same rate.

Joint Rates

Most rail traffic moves over two or more railroads' lines, and common rates and divisions of revenues have been established over the years for such movements. With changing circumstances, these can become unfair in reflecting the divisions of costs, yet the railroad with more rapid cost increases cannot effectively force renegotiation of the division under present law and regulation. Joint rates should change to reflect legitimate changes in costs of operation. Otherwise, the taxpayer can end up covering costs of operations, such as Conrail's, and is essentially subsidizing the shipper or the connecting railroad. The Committee has published for consideration, but has not included in S. 1946, a proposal to reform significantly the current system for allocating divisions.

The proposal under discussion is similar to a compromise reached among many of the railroads. Under these proposals, a rail carrier could recover its losses without having to obtain the other railroad's approval. The compromise is not simply a proposal of "have not" railroads, such as Conrail. Although freedom to set prices competitively

is important to Conrail's viability, the fact that a number of other railroads support reform of joint rates indicates that pricing flexibility is needed by both healthy and marginal carriers.

Without commenting on the specifics of the proposal suggested by the Committee, let me emphasize that we believe that a substantial reform of the system for dividing joint rates is essential to the health of the rail industry. We look forward to working with the Committee to devise acceptable reforms of the current system, based on the draft language or alternative proposals.

General Rate Increases

A common practice in the rail industry is to agree on general percentage-rate increases for all services by all carriers rather than setting specific rates for each commodity and service. This is justified as a response to inflation. However, the practice tends to encourage costs to be passed on and decreases incentives to reduce costs. S. 1946 would allow general rate increases to recover cost increases for two years and would phase out general cost increases entirely after 6 years. Our bill advocates a similar approach, which allows the phase out to occur more rapidly and more evenly. We continue to believe that this approach is preferable. The ICC should also retain its existing authority to limit or deny part or all of a proposed general increase, which S. 1946 would eliminate. On the other hand, we believe that during the phase out period that the railroads should be permitted to recover all allowable costs on a timely basis, rather than being forced by the ICC to rely on data that lag weeks or months behind cost increases.

Contract Rates and Demand-Sensitive Rates

One of the shippers' biggest complaints is that car supply and transit times are uncertain, to the point where rail service is not used although it may be in many instances the most energy-efficient, environmentally sound, and nominally least expensive choice. For many shippers, the answer is contracts between carrier and shipper, that provide for a fixed supply of cars, and guaranteed transit times, in return for a rate that covers all costs and earns a profit that makes the contract worth entering. Car utilization by the railroads would improve under contract terms, and we would see more round trips out of each car when a good profit were being made with each trip.

On the other hand, of course, the small shipper is fearful that he would be outbid by the larger shippers in a contract system, or be left high and dry without any cars during a peak period. But this need not be the case. Contracts actually could serve small shippers best by giving them a means to assure service.

S. 1946 unnecessarily limits the ability to contract, by requiring the ICC to advise each carrier annually how many of each type car it may make available for contract service. Realistically, only year-long contracts would be made, and the small shipper could not buy long-term "protection" at any price. The larger shipper could protect itself in the longer-term by purchasing "dedicated" cars under contract for its use only, leaving the pool of available railroad-owned cars even smaller.

S. 796 would solve these problems. For example, it makes clear that the annual ICC determinations will have no effect on existing contracts, thereby enabling carriers to enter into long-term contracts.

The antidiscrimination provisions in existing law should also be redrawn, as proposed in S. 790, to permit contract rates unambiguously. Finally, contracts should not be reviewable by the ICC except in response to a specific complaint of discrimination or failure to meet the common carrier obligation.

Demand-sensitive rates adjust the price for service depending on the peaks and valleys of seasonal and other demands. The present huge foreign grain sales so beneficial to our balance of payments are an example of peak demand that could be met in advance with demand-sensitive rates. However, these rates must be freed of significant restrictions if they are to serve the needs of those who contract for them, particularly where there is unregulated competition in the form of trucks and barges that can change rates quickly. An averaging technique that allowed some rates charged above and below otherwise sanctioned prices would be ideal, and we continue to believe that this concept of averaging prices as contained in S. 796, perhaps somewhat simplified, would be a useful change.

Rate Bureaus, Notice and Publication

Exceptions to the antitrust laws permit the railroads to join together in rate bureaus to discuss and agree to rates they will charge, both single-line rates that affect one railroad, and joint rates where two railroads are providing service. We support S. 1946's provision to open rate bureau meetings, but not the provision that allows discussion

of single-line rates and joint-rates of other carriers so long as express or implied agreements are not reached. We believe this approach is unenforceable, while S. 796's strict prohibition is enforceable.

The existing requirements for notification before making rail rates effective is an unnecessary barrier to competition. We continue to support a no-notice provision for markets where competing barge and truck carriers are not required to give notice. With respect to other markets, although we would prefer to eliminate all notice, we do support the Committee's shorter 15-day notice provision as a vast improvement over existing law.

Mergers and Lesser Transactions

We strongly support the Committee's approach to expediting lesser transactions, such as joint-use agreements and coordination projects. These transactions hold great promise for improving the efficiency of railroad industry structure. With respect to full-scale mergers, ICC approval and court review of merger proposals is now snarled in as many as 20 separate issues. Many of the considerations which the ICC must take into account are inherently contradictory. Our bill called for the review of rail mergers under normal antitrust law and procedure -- just as mergers are decided for all other businesses. The Justice Department pointed out in House hearings last week how much more swiftly a merger that is not anticompetitive can move through the judicial system compared to the ICC.

If the Committee is seeking to shorten timetables for ICC action further, it might consider following its own lead from the Airline

Deregulation Act, and alter the standard under which mergers are judged. Both S. 796 and S. 1946 propose a standard based on the Airline Deregulation Act that would balance the anticompetitive effects of transactions other than mergers against their transportation benefits. If the Committee does not wish to place rail mergers under the antitrust laws, we suggest that the standard proposed be extended to cover mergers as well as lesser transactions.

Abandonments and Entry

One of the significant costs borne by the railroads is ICC-dictated continuation of service on branch lines that have little or no traffic, when normal business economics would clearly dictate abandonment of service. Present ICC procedures are designed to preserve the common carrier obligation, but they are far too slow.

We applaud S. 1946 for speeding up decisions and clarifying purchase and subsidy options. However, the Committee bill does not allow all money-losing service to be dropped. For this reason, the S.796 approach is more comprehensive and therefore preferable. If the ICC is permitted to require such service, we believe it important that the ICC at least explain where it expects the money to come from to operate such lines. If this were the case, it would be very difficult to justify operations where there was no hope for an eventual return to profitability, or any realistic prospect of subsidy.

I would emphasize at this point our equally large responsibility to ensure that the States and localities affected by a possible abandonment have a full and effective opportunity to plan for and make responsible offers to take over affected operations. The Department, working with the States through the Local Rail Service Assistance Program,

is trying to manage the consequences of service reductions in the communities' interests.

On the subject of entry, we agree with this section of S. 1946. Both of our bills encourage greater competition within the industry by permitting a railroad to purchase track use rights or right-of-way over another railroad's tracks, or to obtain reciprocal switching rights -- on a case-by-case review under S. 1946, and within all urban areas under S-796.

Operations

At present, the ICC has authority over the use of cars and per diem rates for their use, as well as other day-to-day aspects of rail operations. While the ICC is moving toward returning control of day-to-day operations to management, we recommend that you go further and permit the industry to arrange its own enforceable operations and compensation agreements. In unusual cases, ICC action may be necessary. We agree this should be limited to true emergencies, as reflected in the Committee's bill. Short of true emergencies, operational matters are best resolved in the marketplace, not at the ICC.

Conclusion

In conclusion, I want to emphasize once again how pleased we are with the Committee's actions so far. The Administration welcomes the opportunity to continue to work with the Committee as its proposals are further refined in the hope that this Congress will be able to enact legislation in this very important area.